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The effects of the fiscal policy on the SME sector in Romania during the economic crisis

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Abstract

This article's purpose is to analyze Romania's tax policy during the global economic crisis and its impact on the SMEs' sector. We have studied the global and SMEs' specific tax measures taken by the Romanian government in the period 2009-2012 in order to countervail the negative effects of the economic crisis. The research method used is the comparative analysis between Romania and the EU average in terms of tax policy and SMEs' sectors' dynamics. Based on the SBA Fact Sheet Romania data we want to show the connection between the SMEs' sector dynamics in Romania regarding the number of SMEs, the number of employees and the value added and the tax measures that lead to these changes in the analyzed period. We want to underline their initial role and if it was reached using the World Bank data and the European Commission data.

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Keywords: SME sector; Romania; fiscal policy; economic crisis

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1. Introduction

Since 2008, with the start of the global economic crisis, the trend of increasing taxes in EU Member States is clear and has grown steadily in 2010 and 2011. Most European countries have focused more on indirect taxes, but the onset of the economic crisis called for each state to have its own policy regarding taxes (Zai, 2012).

The purpose of this article is to review Romania's fiscal policy during the global economic crisis and its impact on the SME sector. We studied the overall fiscal measures and the specific SME taken by the Romanian government during the 2008-2012 period in order to counteract the negative effects of the economic crisis - rising unemployment, limited access to credit, lack of investment, low consumption etc. The research method used is quantitative analysis of documents and the comparative analysis between Romania and the EU-27 average.

Based on the SBA Factsheet Romania data we want to show the link between the dynamics of SMEs in Romania regarding the number of SMEs, employment and value added and the tax measures that led to those changes in the analyzed period. Through the information given by the European Commission (Eurostat) and the World Bank (Doing Business) we want to emphasize their original role (consumption growth, investment or falling unemployment) and whether it has been achieved.

Regarding the fiscal measures used for the analysis we mention: accelerated depreciation, loss carryforward, differentiated taxation of SMEs' revenue, changes in indirect taxes and social contributions.

2. Literature review

The special scheme for SMEs will lead to severe selection problems, which may prove to be very expensive in terms of inefficient use of resources, and even in the tax revenue. Some arguments in favor of special tax treatment for SMEs is based on capital structure and behavioral characteristics of SME owners, rather than the SME itself (Jousten, 2007).

The fiscal policy of each EU Member State must ensure the funding of public services, and must be able to assume its role of economic leverage in order to influence the functioning of the real economy by encouraging employment and investment (Zai, 2012).

The rates of the effective corporate income have an adverse effect on corporate investment and entrepreneurship. This effect is strong if we look at the rates of other taxes, including the personal income tax, VAT and sales taxes, the measures of administrative burden, tax compliance, protection of property rights, regulation, economic development, openness to foreign trade and inflation. Higher effective corporate income taxes are also associated with lower investment in manufacturing but not in services, a larger underground economy, and greater dependence on debt financing as opposed to their own funding (Djankov et al, 2010).

Empirical studies confirm that real estate taxes, followed by consumption taxes seem to be the least harmful to growth, therefore in Romania and in other EU member states it was decided to increase the VAT rate during the economic crisis. The personal income tax, social contributions and corporate income taxes are considered to be the most damaging to the economic growth (Dascălu and Cojocaru, 2011).

Fiscal policy significantly affects financing decisions. The tax effects appear to be particularly important for companies that approach a state of uncertainty (positive or loss carrybacks when high tax shields predictor of bankruptcy is high) (Mackie-Mason, 1990).

Economists and researchers in economics argue that increasing corporate income tax, personal income tax and social contributions are the most harmful decisions that can be taken during financial and economic downturn. This is explained by the fact that personal income tax cuts stimulate investment, while reducing personal income tax and social contributions increase labor supply and demand with a direct effect on reducing unemployment (Eggert and Goerke, 2004).

3. Research methodology

The research methodology used is analysis and synthesis, quantitative analysis of documents and comparative analysis between Romania and the EU-27 average. We gathered data from Eurostat, World Bank - Doing Business, European Commission - SBA Fact Sheet Romania and Taxation Trends in the EU in order to make a comparative analysis between Romania's and EU's fiscal policy (2008-2012), and the SMEs sectors' evolution in the period 2008-2011. We used the following variables: indirect taxes (% of GDP), direct taxes (% of GDP), social contributions (% of GDP), total charges (% of GDP), number of SMEs (% of total), number of employees (% of total), value added (% of total), number of payments per year, time to pay taxes (hours per year), total tax rate (% of profit).

4. The structure of the tax system of Romania - EU-27 in the period 2008-2012

Taxation is a economic policy's system of each EU Member State which sets the taxes owed to the consolidated budget. In order to properly assess the size of the tax liability of the European countries and in particular the EU countries, it is necessary to know the particularities of each country's tax system. A feature of the EU countries is that they have the acquis communautaire which includes basic principles of taxation that each Member State must apply depending on specific circumstances. Each state has its own organizational structure and specific forms of taxation that are included in the operational mechanisms of the countries concerned. The organization of taxation is based on the national interests of each European state, whose solution determines the development of the policy and the adoption of rules by institutions in each country. Through fiscal policy each state sets taxes to help fund revenues to finance the operating costs for every country (Muntean and Solomon, 2012).

A mismatch between the tax system and the business environment can have negative consequences for the country's future. Legislative stability, elimination of corruption and red tape, reducing the number of liabilities in the form of taxes, contributions and gaps in the legal system, the improvement of tax obligations' collection, the efficient spending of collected resources are some aspects that should be considered when adopting measures affecting the tax system (Dobrotă and Chirculescu, 2010)

Tax compliance, in particular, can be a challenge for small businesses. Tax legislation is often complex and the large differences from country to country raises issues to firms doing business abroad. Tax laws are drafted in a way that allows their application to businesses of all sizes and all types of economic transactions, even for operations that are performed by large corporations. Better regulation will help create more favourable conditions for economic growth to achieve the objective of making Europe a more attractive place for investments and jobs. Improving the European and national fiscal regulations include measures such as simplification, a well-drafted legislation and efforts to reduce administrative costs. This is essential especially for SMEs, which are disproportionately affected by legislative and administrative obligations (Gondor, 2011).

Doing Business records the taxes and mandatory contributions that a medium company must pay in a year and also measures the administrative burden of paying taxes and contributions. It does this through three indicators: the number of payments, time and total tax rate for the firm studied by Doing Business. The number of payments indicates the frequency with which the company must file and pay various types of taxes and contributions, adjusted for how such deposits and payments are made. The time indicator captures the number of hours needed to prepare, document and payment of three major types of taxes: taxes on income, consumption taxes and taxes on work and contributions. The total tax rate measures the tax cost (as a percentage of profit) incurred by the company standard. Indicators do not measure the fiscal health of economies, macroeconomic conditions under which governments collect revenue or providing public services supported by taxation. Ranking on the ease of paying taxes is the simple average of the percentile rankings on indicators components, with a threshold applied to the total tax rate (Doing Business).

Table 1. Paying taxes in the European Union and Romania (2008-2012)

Economy	Year	Paying taxes					
		Payments (no/year)	Time (hours/year)	Corporate income tax (%)	Social taxes and contributions (%)	Other taxes (%)	Total tax rate (% profit)
European Union	2008	17,56	247,40				46,27
	2009	17,35	230,38				44,56
	2010	16,88	221,85				44,23
	2011	16,33	210,65				43,35
	2012	12,33	193,41	12,48	27,71	3,24	43,44
Romania	2008	113	202				46,80
	2009	113	202				46,40
	2010	113	222				44,90
	2011	113	222				44,40
	2012	41	216	10,50	31,50	2,20	44,20

According to the table above we can conclude that Romania is well above the EU average in terms of the number of tax payments per year, although in 2012 there was a reduction of 63.72% of them, for a total of 41 payments compared to the EU average of 12.33, i.e. three times higher. This dramatic reduction is due to the implementation of new legislation requiring employees to submit only a joint state return for all special social security contributions and payroll taxes (Doing Business, Paying Taxes 2013). Thus, it is necessary to further reduce the number of tax payments per year in Romania, and this was implemented by switching to prepay taxes from 2013, as it is already done in France.

From the 1st of January 2013 taxpayers may opt to declare and pay corporate income tax annually, with prepayments made quarterly. This option was introduced in the Tax Code by a law published in September 2011, which comes into force at the beginning of 2013.

Regarding the number of hours per year for tax payment, Romania is above the EU average of 193.41 hours per year with a total of 216 hours per year. And in this case it is necessary to streamline the number of hours required per year for taxes.

Corporate income tax rates and other taxes are higher in the EU than in Romania, while the tax rate on wages and contributions is higher in Romania (31.50%) compared to the EU average of 27.71%.

Regarding the total tax rate as percentage of profit, it decreased both in the EU and Romania in the period 2008-2012. In Romania decreased by 2.6 percentage points reaching 44.20%, higher than the EU average of 43.44%.

There are four types of tax degrees: countries with a low tax rate (below 30%) where Romania fits, countries with average tax rate (between 30-35%) - Greece, Spain, countries with a high tax rate (between 35-40%) - United Kingdom, countries with a very high tax rate (over 40%) - Italy, France, Sweden.

Table 2. Evolution of the main type of taxes as % of GDP in Romania and EU-27 (2008-2010)

Type of tax	Economy	2008	2009	2010
Total charges (% of GDP)	Romania	28	26,9	27,2
	EU-27 average	36,6	35,8	35,6
Indirect taxes (% of GDP)	Romania	12	11	12,3
	EU-27 average	13,6	13,3	13,5
Direct taxes (% of GDP)	Romania	6,7	6,5	6,2
	EU-27 average	12,3	11,5	11,2
Social contributions (% of GDP)	Romania	9,3	9,4	8,8
	EU-27 average	10,7	11,1	10,9

From the Eurostat data, we can notice that total taxes as a percentage of GDP are lower than the EU-27 and fall on a downward trend in 2008-2010. Regarding the tax structure, we conclude that indirect taxes (% of GDP) occupies an important place in total charges in Romania, but is below the EU-27 average; it is followed by the share of social contributions in GDP, which is also below the European average and finally there are the direct taxes. Regarding the EU average, the first are indirect taxes as a share in GDP, then the direct taxes and finally the social contributions. The evolution of VAT as a share in GDP shows that due to the economic crisis the consumption decreases. There is a tendency to decrease indirect taxes (% of GDP) in 2009 in most EU Member States, including Romania. In 2010 there were increases in VAT in the UK, Greece, Romania and Spain. Thus we see increasing indirect taxes as a share in GDP in Romania from 11% in 2009 to 12.3% in 2010.

Increasing the corporate income tax and the personal income tax proved to be the most harmful choices for the economic growth. High rates of social security contributions are negative for people with low incomes. These rates can be used by any state as a tool for stimulating job creation. Romania relies its fiscal policy on indirect taxes such as VAT; however, their share in GDP is below the EU average, so it is necessary to improve their collection and reduce tax evasion. Social contribution rates should be reduced to reach the EU average also leading to stimulating job creation and reducing unemployment with the positive effects associated with them.

5. General and specific tax measures impacting the SME sector taken in Romania in the period 2009-2011

Some of the most significant tax measures taken by the Romanian government in 2009 are:

- Reduction in VAT (from 19% to 5%) for social housing and, subject to conditions, private houses not exceeding 120 m2 and a value of 380.000 RON (€ 90,000)
- Firms that have experienced a loss or zero profit were required to pay a lump-sum tax from May 2009 to October 2010
- The period for loss carryforward increased from 5 to 7 years applicable in 2009. There is no provision for loss carrybacks
- Increased social contribution rates of employees and employers, decreased employer contributions for work accidents and occupational diseases by 0.5%
- Taxpayers who receive income from agricultural activities will have to pay tax on the gross income of 2%
- Temporary tax exemptions on capital gains from real estate transactions on the capital market in Romania
- Reduce taxes on dividends of non-residents from 16% to 10%

- Increase in the excise tax on alcoholic beverages, cigarettes and fuel in April 2009.

The most important fiscal measures taken by the Romanian government in 2010 are:

- Increase in the standard VAT rate by 5 percentage points to 24%
- Increase the personal income tax base and social contributions by charging lunch vouchers and capital gains (including interest on bank deposits)
- Temporary tax exemptions on capital gains from real estate transactions on the capital market in Romania
- Deferral of tax liabilities in the period January-June 2010
- Simplification measures for persons entering into insolvency
- Only in August 2010 were published the rules for granting deduction of 20% to the corporate income tax calculation for eligible R&D expenses and the ability to use accelerated depreciation method for devices and equipment used in R&D. In determining eligible expenditure, fixed assets used in development activities can benefit from the same accelerated depreciation under the Tax Code.

In 2011 the following tax measures have been taken:

- Broadening the tax base of personal income tax to cover income from capital gains, including interest on bank deposits, compensation payment and lunch vouchers
- Personal income tax of 3% obtained by micro-enterprises (with 1-9 employees and a turnover of less than € 100,000) is reintroduced as an alternative general corporation tax (16%)
- Level the limit of social contributions for both employers and employees
- The reverse charge for the supply of cereals and industrial plants was applied from 31st of May 2011
- Excise duty on cigarettes and energy increased
- Increases in certain local taxes (such as car tax, taxes on the issuance of certificates, notices and authorizations for advertising).

6. The evolution of SME sector in Romania in the period 2008-2011

In 2010 compared to 2008, there was a fairly significant increase in the number of SMEs (18.96%) in Romania due to the growing number of micro-enterprises (19.33%) and then to the number of small firms (18.49%). In 2011, in comparison with 2010, the growth was much lower, only 1%; a positive trend recorded only the micro-enterprises (2.34%), the rest recording decreases in the number of companies, particularly medium-sized companies (-13,66%).

Table 3. Number of SMEs, of employees and value added in Romania (2008-2011)

	Number of SMEs			Number of employees			Value added		
	number		Variation	Number		variation	billion €		variation
Type of SME	2008	2011	%	2008	2011	%	2008	2011	%
Micro	389.389	475.536	22,12%	876.357	993.079	13,32%	11	6,6	-40,00%
Small	41.5	45.131	8,75%	821.061	840.848	2,41%	12	8,2	-31,67%
Medium	9.174	8.348	-9,00%	935.751	843.021	-9,91%	14	9,4	-32,86%
Total SMEs	440.063	529.015	20,21%	2.633.169	2.676.948	1,66%	37	24,2	-34,59%

Regarding the number of employees in the SME sector in Romania in 2008 and 2010 we notice an increase of 14.02%, mainly due to the persons employed in micro-firms (22.76%) and those employed in small firms (17.16%). In 2011 compared to 2010 we register a decrease in the number of employees in SMEs (-10.84%), mainly due to layoffs in medium-sized companies (-12.6%) and those in small ones (- 12.59%). Value added of SMEs in Romania expressed in absolute value (billion) fell quite a lot in the period 2008-2010, 29.73%

respectively. In 2011, compared to the previous period, the downward trend has continued but at a slower rate (-6.92%). Consequently, the value added decreased from 37 billion in 2008 to 24.2 billion euros in 2011, marking a 35% fall.To sum up, we can say that in 2011, compared to 2008, there was an increase in the number of SMEs by 20.21%, which is mainly due to micro-enterprises, an increase in the number of employees in SMEs by 1.66%, mainly due to hiring by micro-firms and value added decreased by 35%, due to micro-companies that registered a fall of 40% in value added. In the period 2008-2011 micro-firms increased in number by 22.12%, have hired more people by 13.32%, and value added decreased by 40%. Concerning small firms, their number has increased by 8.75%, the number of employees increased by 2.4% and value added decreased by 31.67%. Regarding medium-sized companies, their number decreased by 9%, the number of employees was reduced by 10% and the value added decreased by 32.86%.We conclude that micro-firms are the least effective and should be taken measures to stimulate investments in research and innovation to increase value added. Small companies rank second and medium sized firms rank first in terms of efficiency, but the last ones should be encouraged to create new jobs.

Conclusion

Although Romania establishes its fiscal policy on indirect taxes such as VAT, their share in GDP is below the EU average, so it is necessary to improve collection by reducing tax evasion Romania is well above the EU average concerning the number of tax payments per year, while in 2012 it reached a total of 41 payments compared to the EU average of 12.33. This dramatic reduction is due to the implementation of a new legislation that requires employees to submit only a joint state return for all special social contributions and payroll taxes. In the period 2008-2010 the fiscal burden decreased in the EU. Increasing the personal income tax and corporate income tax are considered to be the most harmful for the economic growth so that Romania has decided to decrease in 2009 and 2010 the share of direct taxes in GDP hoping to attract investors and stimulate domestic firms to invest. In order to save jobs and to stimulate the creation of new jobs, Romania decided to reduce social security contributions as a percentage of GDP in 2010 compared to 2008 by 0.5%. This has led to an increase in the number of employees in SMEs in 2010 compared to 2008 with 14.02%. The austerity measures taken by the Romanian government in 2010 like cutting wages by 25% to 40% (including bonuses), applying a 5.5% health insurance contribution to pensions greater than 740 RON and increasing the standard VAT rate with 5% have caused a decrease in the purchasing power of the entire population and sales, the companies had to adapt to the demand and reduce costs, mainly the social ones. The main effects of increasing microeconomic standard VAT rate by 5% in 2010 were: increased costs and lower profit recorded by the Romanian firms, the reduced purchasing power of consumers has led to a decline in demand, sales and profits as well as an emphasized phenomenon of tax evasion. In 2011 in Romania the number of employees in SMEs fell below the EU average due to the increase of the standard VAT rate by 5% in July 2010, leading to a decrease in consumption, sales and profits, so employers have had to cut social costs. The rise of the personal income tax base, social contributions and capital gains have also had a significant impact on reducing the number of employees in 2011. The lump-sum tax on micro-enterprises that was mandatory in May 2009 - October 2010 has been repealed. As a consequence, the share of micro-enterprises has improved in 2011 compared to 2010 by 1.1%. Moreover, the number of Romanian SMEs in absolute terms increased by 20% during the period 2008-2011. The main consequences of the introduction of the lump-sum tax in Romania in May 2009 on SMEs' turnover were: an increase of the number of natural authorized persons, a rise of the number of suspensions and dissolutions, a decrease of the number of employees in SMEs, a diminishing declared turnover, a negative perception of business and an increase of tax evasion. In 2011 the share of Romanian SMEs' value added in total value added increased by 7% compared to 2010 due to lower exports made by the large firms to the EU member states, an area severely affected by the global economic crisis, which resulted in a lower value added of large firms in total value added in favour of medium enterprises.

Unfortunately the 20% additional deductions in calculating corporate tax of eligible costs for companies dealing with R&D activities and the accelerated depreciation of patents and of certain technological equipment necessary for the R&D activity have led only to a slowdown of the abrupt decrease of the SMEs' value added. Although incentives for R&D were introduced in January 2009, the implementing rules were published in August 2010 so since 2010 we can notice a diminishing downward trend in the share of SMEs' value added in total value added. The lack of specificities in the period January 2009 - August 2010 led to discouragement or delay in R&D investments. The decrease of the Romanian SMEs' value added with 35% in the period 2008-2011 may be caused by the economic crisis and especially the EU economic and financial problems, the adoption of lump-sum tax in Romania, the consumption decrease due to the rise in the VAT rate in our country and the austerity measures adopted by the Romanian government.

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